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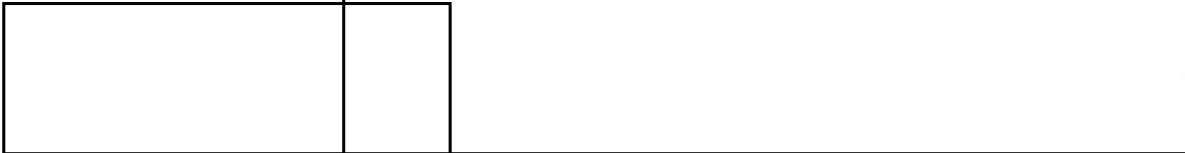
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THE SOVIET WORLD

Numerous manifestations of the Soviet Orbit's coexistence campaign during recent weeks suggest that Moscow is making a major co-ordinated effort to exploit this theme and hopes it will have great influence on world opinion.

The campaign has been particularly noticeable in the friendly attitudes the Satellite countries have adopted toward Western diplomats at recent state functions. In mid-November all Western military attachés in Poland were invited to a hunting party



tinue." On 11 November, Rumania relaxed travel restrictions to Hungary, Bulgaria and Yugoslavia, and on 15 November American officials traveled these routes without interference.

At the same time, however, the Hungarian and Czech governments have been quietly trying to reduce the operational efficiency of the American diplomatic missions in Budapest and Prague. In Hungary, a native employee of the legation was arrested and travel restrictions there have been more stringently enforced. In Czechoslovakia, eight local employees have been forced to quit in the last three months. There is no uniform discrimination against American representatives in the Satellites, but these low-level harassments manifest a continuing policy of limiting the capabilities of Western diplomatic missions.

Some Satellites have removed specific sorepoints in relations with the West in their release of prisoners of international reputation. Poland's release of Herman Field and Hungary's liberation of Noel and Herta Field follow a long series of protest notes delivered by the American government during the last five years. Hungary's release of Anna Kethly, an internationally known Social Democrat, may be regarded as a conciliatory gesture to Socialist and Trade Union circles in Western Europe which have been agitating for her liberation for several years. The release of Israeli citizen Simon Orenstein, who was implicated by the Czechs during the Slansky affair in 1949, may be a step in a cautious Orbit rapprochement with Israel.

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The recently intensified Soviet effort to woo Yugoslavia reached a new climax when four of the top Soviet leaders--Malenkov, Khrushchev, Molotov and Bulganin--toasted both Marshal Tito and the Yugoslav Communist Party at a reception at the Yugoslav embassy in Moscow on 28 November. The toasts constituted the first direct Soviet "approval" of the "heretics" of Communism since the 1948 split.

The new Chinese Communist ambassador to Finland recently sent notes to the missions of countries which do not recognize Peiping, informing them that he had presented his credentials and expressing a hope that he could "enter into good connections" with the addressees "for the promotion of the relations between our two countries." The American embassy received no note.

Developments at the opening sessions of the Orbit security conference in Moscow suggest that the purposes of this meeting are to establish the framework of a general collective security system open to all European states, and to warn Western Europe of the consequences of ratification of the Paris agreements, at the same time preparing the ground for subsequent Orbit moves to counterbalance West German rearmament.

Molotov in his opening speech declared that the "remilitarization" of West Germany will require the states participating in this meeting to "take common measures in the field of organizing their military forces and their commands" and to "rally their forces and considerably strengthen them." The Czech and East German premiers have echoed Molotov's proposal, and in particular emphasized co-operation among Czechoslovakia, Poland and East Germany. They have not clarified the exact nature and timetable of such common measures, but have implied that this conference should lay the groundwork for the establishment of an Eastern security arrangement to counterbalance NATO. Apparently the Moscow conference decisions will not be fully implemented until final ratification of the Paris agreements.

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MENDES-FRANCE AND NORTH AFRICA

The problem of North Africa poses the most serious threat yet faced by the Mendes-France government. The premier's main hope of surviving the debate on this issue scheduled for 10 December lies in the unwillingness of many deputies to precipitate a crisis before the National Assembly acts on the Paris accords. His hand will be strengthened considerably if his plan for a peaceful settlement of the terrorist problem in Tunisia has by then shown clear promise of success.

The American embassy in Paris believes a majority against the government could be mustered in the assembly on the North African question now. The outburst in Algeria on 1 November was a considerable shock to most Frenchmen, who had regarded that area as safe from disturbances like those in Tunisia and Morocco. Rightist opponents of the premier immediately charged that the government's conciliatory Tunisian policy was responsible.

The willingness of the premier's opponents to exploit anxiety over the growing seriousness of the North African situation was apparent in the assembly vote of 12 November postponing debate on the Algerian disorders. The Popular Republicans, who had abstained on similar votes in August, and the Communists, who had supported the government in August, voted against the premier. A group of Gaullist Social Republicans has consistently opposed the government on this issue, despite the party's participation in the cabinet.

Mendes-France is making every effort to refute the charge that he is following a "soft" policy. He is attempting to stop foreign encouragement of the North African nationalists. He has repeatedly castigated Egypt for inciting North African nationalists against France, and he assured the assembly on 12 November that Algeria will remain part of France.

A Foreign Ministry spokesman recently reiterated a French threat to hold North Africa even at the expense of NATO commitments. In the event of new outbreaks in North Africa France can be expected to continue to strip its European contingents and will probably use MDAP equipment against the nationalists.

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Mendes-France hopes to hold his coalition in line by a mixed policy of force and conciliation in North Africa. Severe repression of further outbursts in Algeria would be generally approved by the French public and parliament. Mendes-France scored a success on 23 November when the Tunisian government accepted a compromise based on a French proposal to permit the quasi-military fellagha to surrender without fear of reprisal. The truce teams are now in contact with the fellagha in Tunisia and the results of their talks are expected to be known before 10 December.

In Morocco, Mendes-France would like to institute a dramatic change in policy both to satisfy liberal elements in parliament and to counteract Arab propaganda. Though a program of limited reforms has been prepared for Morocco, a speedy solution is impossible because of the impasse over the dynastic issue. He has succeeded in persuading moderate Moroccan leaders to discuss reforms, but terrorist activity continues and rightist parties in the assembly will not permit any weakening now.

Ambassador Dillon believes that the French Communist Party may be trying to make the North African issue into "another Indochina" as far as French domestic politics is concerned. The Communists apparently hope to extend their influence in the assembly by attacking the premier whether he adopts a firm or a conciliatory policy toward the North Africans. They are evidently encouraged in this hope by having already obtained some rightist support for a resolution critical of the premier's drive against alcoholism.

Despite the personal prestige Mendes-France built up on his American trip, his general position in the assembly has deteriorated considerably in recent weeks. A misfire on the Tunisian truce agreement, combined with the growing reluctance of deputies to share responsibility for the Paris accords, might lead to his overthrow in the debate of 10 December.

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JAPAN'S PLANS FOR ASIAN ECONOMIC CO-OPERATION

Japan has been developing since the spring of 1953 plans for regional economic co-operation in Asia which are designed to bridge the nation's critical trade gap. The government hopes to combine these plans with the proposed American program for economic development in Asia, and thus become both a contributor and a recipient of aid.

Prime Minister Yoshida's proposal in Washington for a four-billion-dollar American economic aid program for Southeast Asia reflects Japan's interest in the development of that area as an indirect method of gaining needed markets and assured sources of raw materials. As the only highly industrialized nation in the Far East, Japan would hope to benefit by supplying capital equipment to the underdeveloped areas and by developing resources essential to Japan's industrial needs.

A report submitted to the government by the semiofficial Japanese Asian Economic Council in August stressed the importance of integrating Japan's economic assistance with Point Four, the Colombo Plan, and other international projects in which the recipients themselves participate as a group. This was deemed necessary to quiet other Asian countries' suspicions of Japanese economic imperialism, as well as to enlist their co-operation in solving foreign exchange and other problems on a regional basis.

Japanese planning started early in 1953, as American spending in Japan declined and Japanese trade in South and Southeast Asia appeared to have reached a maximum under then existing conditions. It was recognized that Japan would have to settle its reparations problems and establish full-scale diplomatic relations before it could expand trade significantly.

Japan planned to utilize reparations as an initial stimulant to create a demand for Japanese goods and know-how and to demonstrate Japan's interest in co-operating in various national development programs. This meant switching from payments made exclusively in services--as provided in the Japanese peace treaty--to a policy whereby Japan would also pay part of the costs of raw materials used in the manufacture of goods to be shipped as reparations payments. This idea was incorporated in the recent agreement with Burma, along with a Japanese promise of long-term loans and investments to further Burma's eight-year plan. The agreement was tied to a peace treaty and to a commercial agreement allowing Japan to increase its normal trade simultaneously.

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A prime feature of Tokyo's regional economic planning is the emphasis it places on lending, investing and the granting of technical assistance by Japan in Southeast Asia in the basic fields of transportation, power, agriculture, fisheries, and even education, health and sanitation. This aid is considered a prerequisite to any large increase in trade and private investment. At the same time, Japan envisages American loans to develop and modernize its own industries.

The chief obstacles to Japan's economic co-operation program, aside from resentments remaining from World War II, are high Japanese prices, shortage of investment capital and keen European and American competition. To bring down prices, the Japanese government has continued its deflationary policy, kept the budget within bounds and encouraged various forms of export subsidies, some of which smack strongly of dumping.

In a fundamental attack on internal economic problems, both conservative parties have recently come out for a controlled economy, with prices and wages controlled, raw material imports centralized, and plants modernized on a priority basis. Additional capital is to be obtained through a new fiscal policy which will promote savings, regulate loans and channel investment into key industries.

To date, Japan has invested or extended technical aid in South and Southeast Asia for iron mines and fisheries development; assembly of irrigation pumps, diesel engines and electric motors; manufacture of textiles, chinaware, and pharmaceuticals; and building of thermal generating plants. In addition, contracts concluded or under negotiation involve caustic soda manufacture, pearl trading, lumber, marine transport, a joint development bank in Indonesia, and exploitation of salt beds in Thailand and Indochina.

Japan can probably increase its trade with South and Southeast Asia substantially over the \$485,000,000 in exports and \$603,000,000 in imports recorded in 1953, given its own efforts, reparations settlements, and the institution of a co-ordinated regional development program. This will tend to give Japan a greater stake in the defense of the area against Communism.

At the same time, a rapidly expanding population will still force Japan to look outside of Southeast Asia for perhaps two thirds of its total trade. Unless this need is met, the lure of the China market will remain a threat to Japan's co-operation with the free world.

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USSR SEEKS SCANDINAVIAN GOOD WILL

During the past year the USSR has conducted an intensified campaign of conciliation aimed at overcoming the Scandinavians' traditional dislike and fear of the Soviet Union. This Soviet effort is not likely to modify the basic Western orientation of the Scandinavian countries, but it has had some success in exploiting local economic conditions and the widespread desire for reduced international tensions.

Probable Soviet objectives--of which the Scandinavians are generally aware--are (1) to increase the economic dependence of Scandinavia, particularly Iceland and Finland, on Soviet trade, (2) to keep Finland neutral but susceptible to Soviet pressure, (3) to maintain Sweden's traditional alliance-free status, (4) to discourage Norway's and Denmark's contributions to NATO, possibly with the hope of eventually inducing them to leave that organization, and (5) to get Iceland to denounce the defense agreement with the United States, forcing the abandonment of the American base at Keflavik. Principal Soviet targets seem to be Finland and Iceland, which are the most vulnerable economically and have pro-Communist parties usually polling over 20 percent and 15 percent respectively of the popular vote, as contrasted with the mere five percent in the other three Scandinavian countries.

The greatest Soviet successes have been in promoting trade relations. The shipbuilding industry in Finland has become heavily dependent on exports to the Orbit and Communist trade promotion has had considerable success. The USSR has become Iceland's second largest market for frozen fish, and between 1 August 1953 and 31 August 1954 an estimated 20 percent (\$10,000,000) of all Icelandic exports went to the USSR. Both Norway and Sweden have increased their trade with the Soviet Union during 1954, but Danish-Soviet trade negotiations were broken off last July as a result of the Danish refusal to build embargoed tankers.

Soviet naval visits to Stockholm and Helsinki in July had a generally favorable effect on the Swedes and Finns. The conclusion of an agreement in September between Sweden and the USSR to co-ordinate air-sea rescue activities in the Baltic also appealed to Swedish opinion, even though, as the Swedish press pointed out, the pact merely formalized what friendly countries would do on an informal basis. According to press reports, Swedish fishermen are now

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generally less liable to seizure if they penetrate the 12-mile limit off Soviet-controlled areas. The Danish Foreign Ministry states that it knows of only one instance during 1954 of a Danish vessel being stopped by the Russians, presumably for being within the 12-mile limit.

There has been a lively and growing exchange of commercial, trade union and cultural delegations between all the Scandinavian countries and the Soviet Union. A noteworthy example was the visit to Iceland last September of two ten-member Soviet delegations, one of artists and the other of scientists. According to all reports, most Icelanders felt that they had never before been honored by such distinguished delegations.

During the past year or so the political complexion of the Scandinavian delegations invited to the Soviet Union has changed. Formerly they were composed mostly of Communists and fellow travelers, but they now include an increasing number of strongly pro-Western individuals. Finnish Social Democratic leaders Fagerholm and Leskinen, who had earlier been labeled by the Communists as archenemies of the Soviet Union, informed the American embassy in Helsinki on their recent return from the USSR that they were told Moscow wanted to be friends with the duly constituted authorities in most states, whether they were anti-Communist or not.

An even more pronounced Soviet gesture toward Finland was the announcement on 19 September, the tenth anniversary of the Soviet-Finnish armistice, that the Order of Lenin had been awarded to President Paasikivi. Equally unprecedented was the Soviet apology for an overflight of Finnish territory by Soviet aircraft. The Finns have not reacted enthusiastically to these gestures, but have expressed hope that they augur well for future relations.

In general the Scandinavians have cautiously welcomed the Soviet gestures of friendship, and the standing of local Communists and fellow travelers has been somewhat enhanced. Nevertheless, there has been no basic change in Scandinavian opinion regarding the USSR and its ultimate intentions in the area.

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INCREASE OF TENSIONS IN SOUTH AFRICA EXPECTED UNDER NEW PRIME MINISTER

The choice of Johannes Strijdom to be prime minister of South Africa will lead to a gradual increase of racial and political strife--an intensification of conflict between the blacks and whites as well as greater bitterness between the Afrikaner and British elements.

The selection by the Nationalist Party caucus on 30 November of Strijdom, 61-year-old "wild man of the Transvaal," represents a victory for the extremist element in the party. His advocacy of a republic and strict repression of nonwhite elements reflects the traditional rural background of his Nationalist followers. Most of the Afrikaners have not forgotten the independent Boer republics of the late nineteenth century, nor have they forgiven the British for their imperialism of the Boer War era and the subsequent commercial and cultural supremacy. The fanaticism of this extreme wing, however, will be tempered by the moderation of the Cape's provincial leaders and the political necessity of keeping a united Nationalist Party.

Because they fear inundation by the non-Europeans--Africans, Coloreds and Indians--who outnumber the whites four to one, the prime minister and his followers are prepared to place racial purity above the economic necessity of integrating non-Europeans into the industrial life of the nation. Among the measures which Strijdom may be expected to push are removal of the last non-Europeans from the common voting roll, separate labor unions, and implementation of the 1950 law decreeing enforced residential segregation.

Further repression of the non-Europeans will widen the gulf between them and the whites, strengthening their belief that force is the only way to put an end to white domination. Communists and other extremists will become more powerful in non-European organizations. Government suppression will force the non-European movements underground, and although they are weakly organized now, their potential for strikes, riots and sabotage will grow.

An extremist Nationalist program will provoke bitterness between the Afrikaners and the English-speaking minority, which constitutes about 40 percent of the whites. The British suspect the Afrikaners of seeking to undermine the constitution on the questions of the Colored franchise and the

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powers of parliament, and fear that their language and culture may be submerged. Any declaration of a republic, even if favored in a plebiscite, would seriously divide the European population.

In foreign relations South Africa is likely to take a more isolationist stand, although not one of neutrality in East-West relations. Continuation of a friendly policy toward the United States, including the supplying of uranium and other strategic minerals, is to be expected. Opposition to consideration by the United Nations of South African problems will be intensified.

Withdrawal from the Commonwealth, while being given increased vocal attention, still remains improbable, largely because South Africa gains tangible benefits from Commonwealth membership in terms of defense, international prestige and access to the London capital market. Recognition of native African states as members of the Commonwealth, however, would place a severe strain on South Africa's ties with the Commonwealth.

There now appears to be no effective challenge to Strijdom's position. Afrikaner parties have splintered in the past, but in view of strong Nationalist discipline and the weakness of the opposition, Strijdom should be able to control his party at least until the 1958 elections. His victory means an even more racist South Africa--a situation which may endanger the multiracial experiments now being attempted in the Rhodesias and in British East Africa.

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COMMUNIST GAINS CONTINUE IN MALAYA

The political and psychological climate in Southeast Asia since the Geneva conference appears to have made Malayan Chinese, particularly the younger elements, more susceptible to Communist approaches. The "selective terrorism" which became evident in 1952 has continued, and there has been an increase in subversive activity. Meanwhile Malayan political leaders, although agreeing with the government that full independence must await the end of the state of emergency declared in June 1948, discount the local Communist problem as trivial.

Communist success in recent months has been most noticeable in the Chinese schools, which have long been a primary Communist target. In Singapore the authorities have discovered an increased number of Communist study groups, general unruliness has grown, and the Communists have found that the issue of compulsory military training can be used to attract participants in anti-government demonstrations. According to one Singapore principal, his students feel that compulsory military training, imposed by a colonial government which is preparing for a gradual withdrawal, is inconsistent with what they call the "new status of Chinese" in Asia. Chinese elders tell government officials they are unable to control their young people and that many youths go to the jungle for Communist indoctrination and then return to their homes. 25X1

Patterns of subversion also persist in other segments of Malayan society. Efforts to establish cells among the Malay and Indian communities continue and are achieving some success, and penetration of the locally recruited home guard is a major government problem. Authorities believe Communist activity is increasing in both the United Malay Nationalist Organization (UMNO) and the Malayan Chinese Association (MCA), the two most active nationalist groups.

25X1 [redacted] Communist guerrillas have achieved much greater flexibility as a result of a gradual reorganization and redeployment taking place since 1952, and independent platoons are now able to range over two or three districts receiving food and intelligence from their local supporters.

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Communist terrorists in north Malaya appear to be moving toward the Thai border area, where the party has established a strong base and is believed to exercise considerable control over both the Chinese and Malay population. 25X1

selective terrorism, directed primarily against government forces and informers, continues elsewhere in the Federation, with the greatest number of incidents occurring in those major rubber and tin producing states where there are the most Chinese and where support is most readily obtainable--Johore, Negri Sembilan, and Perak.

Meanwhile a leading Malay nationalist has qualified statements he had made earlier indicating that demands for self-government had temporarily abated. In mid-October UMNO chairman Abdul Rahman affirmed categorically to the UMNO annual congress that the end of the emergency was prerequisite to the attainment of full independence. In early November, however, he stated that self-government can and should precede the end of the emergency. He characterized the local Communist danger as "very insignificant" aside from being "an irritation and a financial drain," and denied Communist penetration of UMNO.

Malaya's first federal elections are tentatively scheduled for next July and will be preceded by elections to the Singapore council in March or April. Almost unopposed in the Federation and one of the principal contenders in Singapore will be the UMNO-MCA alliance, a successful Malay-Chinese political partnership through which the Malays hope to gain independence and the Chinese, as a by-product, expect political and cultural benefits. With the political consciousness and awareness of outside influence increasing among the people, Malayan political leaders recognize the popularity and vote-getting power of a strong anticolonialist stand. In such an atmosphere the Communist demand for a united struggle against the "British imperialists" may yield additional Communist gains.

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THE STOCKHOLM WORLD PEACE COUNCIL MEETING

The meeting of the World Peace Council from 18 to 23 November in Stockholm provided an outline of the general content and priorities of the Communist propaganda offensive for months to come which suggests that Moscow expects to follow its current policies unchanged.

The delegates' speeches and the final resolutions adopted hewed to the line of "coexistence" and a united front. In Europe, which is apparently to continue as the priority target, the key to coexistence was defined as the immediate opening of four-power talks to reunite Germany and to conclude an Austrian treaty and the immediate convening of the Soviet-proposed collective security conference of all European states--which are treated as the only means of preventing German rearmament and a consequent increase in the danger of war. WPC Bureau member Isabelle Blume stated that a WPC-sponsored European conference to oppose German remilitarization is scheduled for the second week of December in Paris, a few days before the French assembly begins to debate the London and Paris agreements.

Speeches and resolutions at Stockholm took the position that the key to coexistence in Asia and the Near East is the establishment of collective security on the basis of the Sino-Indian five principles--mutual respect for territorial integrity and sovereignty, mutual nonaggression, mutual non-intervention, equality and mutual benefit, and peaceful coexistence. These principles, as spelled out in the resolutions on Asia and on dependent countries, require the defeat of all military blocs such as the Manila pact, the Turkish-Pakistani pact, an end to foreign interference and the withdrawal of foreign military forces, Chinese Communist representation in the UN, and the cessation of armed conflict in Malaya, Kenya and North Africa.

Latin America received greater attention than at past WPC meetings, in the form of coverage in Communist propaganda media and the adoption of a resolution devoted entirely to Latin American problems.

The WPC resolution on disarmament lagged considerably behind recent Soviet tactics in the UN asserting that the peaceful use of atomic energy will be possible "only after the prohibition of the use of this energy for military purposes." This was not included as a condition for adoption

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of the "atoms-for-peace" plan in the UN resolution passed on 23 November with Soviet support.

The WPC disarmament resolution demanded "immediate agreement on the prohibition of experimental explosions of atomic and hydrogen bombs," and was similar to India's UN proposal for a moratorium on atomic and hydrogen development. Moscow has carefully avoided supporting this proposal in the past, apparently in order not to circumscribe its own activities in this field. The resolution appears to be an attempt to curry favor with New Delhi.

If all the conferences suggested for 1955 are held, WPC capabilities would be significantly increased. The only peace meeting explicitly proposed by the WPC is a "world peace assembly" scheduled for 15 May. However, speeches at Stockholm contained scattered references to regional peace conferences which Asian and Latin American peace partisans will attempt to organize in the coming year. Vague references by Asian speakers to an "Afro-Asian" conference in Indonesia and to an Asian conference in India suggest indecision about the details of the Asian "peace" program for 1955. A Latin American conference to discuss political, economic and cultural imperialism in the area was called for by several Latin American speakers, but not specifically scheduled. The immediate convening of a "world scientific conference" to discuss means of banning atomic weapons was proposed by several speakers. Other indications of projected efforts to mobilize scientists suggest considerable exploitation of this issue in 1955, even if no "world scientific conference" is held.

The list of recommendations on cultural activities contained detailed instructions to national peace organizations on how to expand cultural exchanges. The list stressed the importance of celebrating national cultural anniversaries as a means of identifying the peace movement with popular sentiments. Like the long resolution on internal organizational problems, it had all the earmarks of current Communist Party instructions to the cadres on the essentials of united front activities.

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USSR REVISES ITS CONTROLS IN EAST GERMANY

Since the grant of ostensible "sovereignty" to East Germany on 25 March, Soviet controls have been altered to resemble more closely those that prevail in the other European Satellites. These changes indicate that the Soviet Union is now operating in accordance with a long-range plan for control and supervision of East Germany. Because of the special situation there, however, this system of controls cannot remove the need for the presence of Soviet troops to the extent that it has in other Satellites.

The Soviet high commission remains technically the supreme authority in East Germany and still handles relations with the Western powers based on four-power agreements on Germany. Most of the commission's functions, however, have been transferred to the Soviet embassy in Berlin, which now plays a role similar to that of the USSR's diplomatic missions in the other Satellites.

The ambassador forwards Moscow's orders to the local Communists, as is the case in the other Satellites. In addition to the usual large diplomatic staff, the embassy also has political and economic advisers and a military staff for "civil affairs" whose "advice" has the force of direct orders.

The political advisers review major policy matters and exercise control over the Socialist Unity Party (SED). At the local level, control of political activity is apparently exercised by the six consulates which have replaced the high commission's district offices. The frequency of dissidence within the party in the provinces makes this political control, which is supported by various covert organizations, an important function of the Soviet consulates.

Soviet economic control has diminished slightly during the past year, primarily because of the cessation of reparations and the diminution of supervision at the local level, but the over-all direction of the economy continues. Advisers recently assigned to certain economic ministries have probably taken over the direct economic supervision formerly exercised by the high commission at the governmental level. These advisers, of whom there are apparently three in each ministry, are experts in their fields and are given high-ranking positions. Although some of the Soviet advisers

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in key industrial enterprises in several Satellites are reported to have been withdrawn during the past year, there is no evidence of a reduction of their numbers in East Germany. In Wismut, the East German uranium enterprise, Soviet control is direct and all-encompassing.

In addition to the local supervision, the East German economy is also subjected to Soviet direction through the Council of Mutual Economic Assistance (CEMA) of which East Germany is a member. Aspects of the East German economy known to be under CEMA direction are the application of Soviet standards and the integration of planning with that of other Satellites.

The basic force behind Soviet control in East Germany remains the army of occupation. The continued presence of the Soviet forces, including security troops, ensures the submission of the East German population and outweighs the ostensible sovereignty granted by the USSR. As in the other Satellites, the control of the indigenous security and armed forces is maintained through directly assigned Soviet advisers.

It is doubtful that the Soviet Union can risk a substantial reduction of its military establishment in East Germany in the foreseeable future because of its contiguity with the West, the marked hostility of the people toward Communism, and the strong desire in both East and West Germany for unity. A token reduction of Soviet forces, however, could be carried out. The USSR will probably continue to strive to reduce the appearance that East Germany is an occupied country by granting more power to indigenous Communists and withdrawing Soviet authorities somewhat farther into the background.

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**WESTERN EUROPE SUFFERS SETBACK IN PROGRESS TOWARD FREER
TRADE AND CONVERTIBILITY OF CURRENCIES**

Western Europe's economy, already at an all-time high in industrial production, has in the past two years made marked progress toward the convertible currencies and relatively unhampered trade characteristic of prewar days. Developments at the September meeting of the International Monetary Fund (IMF), at subsequent meetings of the Organization for European Economic Co-operation (OEEC)*, and at the current Geneva session of the contracting parties to the General Agreement on Tariffs and Trade (GATT) indicate, however, that these goals are now more distant than they seemed six months ago.

Western Europe's efforts to achieve convertibility and establish trade practices conducive to further economic expansion are complicated by fear of competition and by apprehension concerning American economic policy. The British, whose position is most influential in these matters, see no urgency about making sterling convertible before their next general election, which can hardly be called before next spring and may not occur before October 1956. The outlook for improvement of trade practices is unfavorable.

A generally rising trend in production, trade, and gold and dollar reserves has been apparent in most of Western Europe since early 1953. The unexpected persistence of this trend, in the face of reduced sales to the dollar area attributable to the downward adjustment in the United States, was widely interpreted as evidence of Europe's lessened dependence on transatlantic imports and as indicating early closing of the "dollar gap." It was also seen as evidence that the economies of several Western European countries--notably West Germany, Belgium, and the Netherlands--had recovered and expanded to the point where they could make their currencies convertible into dollars before the end of 1954.

*Austria, Belgium-Luxembourg, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, the Netherlands, Norway, Portugal, Sweden, Switzerland, Turkey, the United Kingdom.

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Since the beginning of OEEC in 1948, the 17 member nations have endeavored, as a condition for receipt of American aid, to remove wartime and postwar import and exchange restrictions and thus help restore competition and reduce costs of production, thereby paving the way for eventual general convertibility of currencies. The increase in industrial production came mostly in the first few years of the OEEC program but is still continuing. Success of member countries in removing import restrictions on trade among themselves, while at the same time building up their gold and dollar reserves, has come mainly since 1952.

By the end of 1953 the OEEC countries, as a group, had removed quantitative restrictions from 75 percent of the goods exchanged by member countries and had increased their gold and dollar reserves from \$7 billion to \$12 billion. This improvement was not uniform throughout the OEEC area, however. West Germany, Britain, Belgium, the Netherlands and Switzerland had removed restrictions from about half of their imports from the dollar area. France, on the other hand, had lagged even in removing restrictions on imports from other European nations and has even to the present removed none from its dollar imports. West Germany had increased its gold and dollar reserves from \$149 million to \$1.2 billion; while Italy's had increased only from \$428 million to \$816 million.

The variations in the rate of liberalization have produced divergent views among the member nations concerning the proper timing and method of any broad move toward convertibility. It has been generally assumed that the European Payments Union (EPU), OEEC's subsidiary for clearing payments among its members, would be liquidated whenever several OEEC member countries made their currencies convertible into dollars. But, in such an event, the countries which found themselves unable to "go convertible" would then have to pay for their imports in convertible currencies without benefit of EPU facilities for dealing with balance of payments difficulties. Also it is feared that if the countries adopting convertibility were not fully competitive with the dollar area, the others would seek to sell as much to and buy as little from them as possible in order to build up their own gold and dollar reserves, thus imperiling the reserves of countries which had adopted convertibility.

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A further source of concern arises from the generally accepted view that convertibility means the end of discrimination against the dollar area. Those OEEC members which are less likely to make their currencies convertible--for example France and Italy--fear they will lose out in the markets of the other members through inability to compete with expanded dollar imports. If these apprehensions are realized, recent progress toward trade liberalization in Western Europe will probably be reversed, with adverse effects on productivity and living standards.

Key role of the United Kingdom

Because approximately 40 percent of world trade is financed in sterling, it is generally agreed that the pound must lead the way in any general return to convertibility. During the latter half of 1953 and the first half of 1954, Britain, with steadily rising gold and dollar balances, took several steps toward convertibility and there were many intimations that the pound might be made freely convertible with the dollar by the spring of 1955. In May of this year the OEEC undertook to prepare the way by directing its experts to study the problems that would arise, and on 30 June the EPU was renewed for one year in the belief that general convertibility would mean its liquidation before then.

Waning prospects for a general return to convertibility in 1954 soon appeared in a clarification of the British position, however. At the mid-July meeting of the Ministerial Council of the OEEC, Chancellor of the Exchequer Butler reverted to a more cautious attitude. It was announced that the United Kingdom had "no timetable for convertibility" and expectations that it was "just around the corner" were discouraged. British officials specified, as a major prerequisite, the adoption by the United States of a "good creditor policy"--low tariffs and some assurance of no sudden changes in them. They pointed out that the outlook for such American action was unlikely to become clear before the November congressional elections and the international review of trade restrictions at the GATT conference opening in Geneva about a week thereafter.

Various domestic considerations, however, loom at least as large as American trade policy in determining the British attitude toward convertibility. Powerful elements in the Churchill government--as well as various industrial and financial groups--do not want to risk "upsetting the apple cart" when things are going well in general for the sterling area. They remember the Labor government's abortive attempt

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at convertibility in 1947, and fear that another failure might permanently impair the pound's standing as a world trading medium. Since Labor Party leaders have thus far refused to give a clear commitment to support a move toward convertibility, the government will probably not undertake it before the next general election.

The United Kingdom has therefore resisted pressure from West Germany and the Benelux countries to take the plunge on sterling convertibility at an early date, and has advocated instead co-operative action to create the conditions for a move toward convertibility for all OEEC countries together. British officials contend that this requires not only a liberal American trade policy but also further progress by OEEC countries in removing restrictions on dollar imports and the provision of adequate stand-by credits to cushion the impact on the weaker currencies.

Current OEEC approach to convertibility and trade

At the ninth annual meeting of the 57-nation International Monetary Fund, which seeks to promote stability and convertibility of currencies among its member countries, the responsibility for hastening the advent of convertibility was "conferred" on the United States. The governors of the Fund--who include the finance ministers of the principal trading nations--argued that general willingness to take the step depends on assurance of a liberal American trade policy to increase dollar earning opportunities for the rest of the world.

The OEEC's Group on Convertibility, meeting a few weeks later in mid-October, also maintained that changes in American commercial policies were necessary. The delegates claimed there had been "no decline in the will to become convertible." It was apparent, however, that they feared exposing some of their industries to the full force of American competition and would not agree to a rigid schedule for the removal of restrictions on dollar imports.

In discussing preparations for convertibility, this meeting paid much attention to problems of the future relationships of the OEEC to the IMF and particularly to the impending GATT conference on the conditions of international trade. There was general agreement that quantitative restrictions against dollar imports could not be entirely eliminated by all OEEC countries even after convertibility had been

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attained by most member countries. Plans were advanced for a European Fund to provide credits to assist member nations who might find themselves in balance of payments difficulties during an interim period after convertibility went into effect.

In the discussions of the OEEC Group on Convertibility, low-tariff countries like the Scandinavian members attacked high tariffs as impediments to further moves toward liberalization and convertibility. But Robert Marjolin, secretary general of the OEEC, emphasized the difficulty of dissociating European tariff problems from world tariffs and pointed out that GATT, not OEEC, has major responsibility for tariffs. The OEEC ministers' meeting scheduled to follow this meeting of the Group on Convertibility was postponed until 12 January. It was expected that by that time the GATT conference, which includes 11 OEEC members, would be near enough its conclusion to indicate the prospects for general liberalization of trade policies.

The first three weeks of this 34-nation meeting at Geneva, do not, however, encourage any expectation of important progress toward a general relaxation of trade restrictions. A number of European and sterling area nations, particularly the agricultural exporting countries, have thus far resisted most efforts to liberalize dollar imports, citing American import quotas on their products as justification. It is generally agreed that until this impasse can be broken, there will be no basis for general convertibility of currencies.

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